$50.00 ANNUALLY
40 Letters Per Year

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

Registered with the Securities and Exchange Commission

Copyright 1960 - Richard Russell

A BEAR MARKET. Today, March 3, 1960, the twenty stocks comprising the Dow Jones Rail Average closed under their November lows, thereby confirming the bearish indications given by the Industrials on February 16th. According to the classic theory formulated by Charles H. Dow at the turn of the century, the two Averages have signaled a bear market in stocks following a period of ten years of unparalleled prosperity. It is now confirmed that the great bull market which began on June 13, 1949, ended on July 8, 1959, and that the movements since then have been part of a primary bear market.

Those of us who follow the teachings of Dow, Hamilton and Rhea know that when a bear signal is given by the Averages, the prediction is for a turn in the tide of the nation's economy as well. When the primary trend turns down none of us, whether businessman, investor or laborer can escape unscathed, yet it is important that each of us recognize the danger. There are many readers of these Letters who have never seen a bear market, and they may be tempted to ignore the signal. But the market, like the tide of the ocean, waits for no man, and Dow's Theory has sounded its sternest warning.

If the theory teaches us nothing else, it tells us to heed the final "bloodless verdict of the marketplace." We know that under Dow Theory, one becomes fully invested when the primary trend turns up, and one moves to the "sidelines" when the trend turns down. I cannot emphasize strongly enough the importance of this single lesson. To readers who have disregarded the "voice" of the Averages and who still hold stocks, I strongly advise selling out rather than attempting to "ride them down". To those who own their own businesses or who direct the businesses of others, I suggest "putting your house in order," for Dow's "storm flags" are now flying.

THE EVENTUAL RALLY. Sooner or later there will be a rally which will tend to correct 1/3 to 2/3 of the losses sustained since the highs at T (on chart). Under Dow Theory neither the extent nor the duration of a primary bear (or bull) swing can be predicted in advance, and for this reason nobody can tell from what levels the correction will come. Wall Street "experts" to the contrary, the odds do not favor the retracement's coming from any of the well-advertised "resistance levels" in the Averages.

When a sustained rally does appear, it will be the second reaction (upward) in the bear market, the first reaction having been the advance from September, 1959 to January 5, 1960. "During secondary rallies in bear markets," wrote Rhea, "it is a fairly uniform experience for traders and market experts to become very bullish. They are usually bearish at about the time the upturn comes." Again he observed, "Guessing at bear market rallies is a dangerous business...Experienced traders put out shorts only when, after a normal rally in a bear market, the activity goes dead when the most recent high point is approached again after a dip."

My own guess is that the first rally, when it comes, will serve to clean out the amateur short sellers. These are the people who were bullish at the highs and who usually turn bearish at about the time the downward swing is over. In general, reactions (rallies) in bear markets arrive when the market is in a thoroughly oversold state and when prices have discounted too much bearishness too quickly.

A study of bear markets shows that in the majority of cases, once a bear signal is given the Averages do not better the bear signal points, regardless of eventual retracements. In 1937 Industrials lost about 40% of their total value on the downward swing which produced the bear signal before any sort of sustained rally developed. In 1929 the "bear signal swing" began at 352 (Industrials) and hit 198 before a real correction came. When the rally finally arrived (November, 1929), it carried through to April of 1930, and it took the Industrials back to 294. This great 1929-30 retracement served to "clean out" the shorts as well as bring in the whole new crop of bulls. The shorts, unfortunately, had forgotten that the greater the "crash", the greater the eventual correction; the bulls fared just as badly for they did not realize that they were buying into a primary bear market, and they simply took their medicine later that year.

INFLATION. Despite the widely accepted thesis of "inflation in our time," this week saw the lowly dollar able to purchase the "blue-chip" Dow Jones at 10.5% discount from their January 5 highs. Since the average yield on the D-J Industrial stocks is now about 3.3%, this means that an amount equal to about three years' dividends was lopped off the senior Average over the last two months. At the same time we find that better than two-thirds of all the stocks listed on the New York Stock Exchange are selling from 11% to more than 60% under their 1959 highs.

President Eisenhower told us in his State of the Union message: "1960 promises to be the most prosperous year of our history." But the Averages can see farther than the President and all his committees lumped together, and the verdict of the Averages is that "prosperity" is behind us. During the past number of months while I have been writing of the dangers inherent in the price structure, I have been the recipient of every sort of argument: "How can 'they' let anything happen in an election year?" "What about the 90% margins?" "The Federal Reserve won't allow stocks to go down." "What can I do with the money?" and "I don't want to pay the taxes." But Government with all its powers cannot keep the American people on a buying spree nor can it insure profits for corporations that are squeezed between high costs and falling demand. Stocks are now going down because thousands of investors are losing confidence in the "Fabulous Sixties"; these investors have been quietly liquidating while the optimists sat mesmerized by the sound of their own words.

Detracters of Dow's Theory are spending their time fabricating clever arguments as to why a bear market cannot have begun. Business, they tell us, simply does not warrant lower prices, and they suggest that this is all a "healthy readjustment". Others are writing to tell me that the Rails are a ridiculous indicator of transportation and shipping and that the movements of the carrier Average are meaningless. But the Theory has plenty of meaning for those of us who sold near the highs, and no amount of sophistry and "level-headed reasoning" can obscure the fact that losses since the recent highs have, in many cases, been severe.

If Dow's Theory still works, the newspapers should be coming out with some decidedly less pleasant news in the next month or so. Readers who are skeptical of the ability of the Averages to discount the future might remember this. Perhaps the best test of the Theory would be to save today's newspaper and check it against a paper of say May 1st or June 1st.

"THOSE DOW THEORISTS" Because of the sharp break, many of the New York newspapers are saying that "chartists" and "Dow Theorists" caused the selling. But there aren't enough Dow Theorists in the country to make more than a ripple in the market. Moreover, the majority of true Dow Theorists did not wait for a bear signal to sell; they sold when the danger signals appeared many months ago.

(Written - March 3rd, 1960 - After the close)